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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF AUSTRIA, JULY 6, 1976

REF: EDR(76)18

1. SUMMARY: AT JULY 6 EDRC AUSTRIAN DEL (LED BY GEHR, FEDERAL CHANCELLORY) EXUDED OPTIMISM NOT COMPLETELY SHARED BY SECRETARIAT, CONCERNING OUTLOOK FOR BALANCE OF 1976. REVISIONS TO "MARCH PROGNOSIS" PRESENTED BY AUSTRIANS SHOWED UPWARD REVISIONS OF ALL DEMAND COMPONENTS WITH RESULT THAT AUSTRIANS NOW FORESEE 4 PERCENT RISE IN REAL GNP FOR 1976 (VS. 2.5 PERCENT PROJECTED IN MARCH). MOREOVER, AUSTRIANS EXPLAINED AWAY ALL PROBLEMS IDENTIFIED IN REFDOC BY SECRETARIAT. THEY DID NOT SEE EXCESS LIQUIDITY AS DANGEROUS ON BASIS THAT CREDIT DEMAND WAS LACKING AND AUTHORITIES HAVE ABILITY TO TIGHTEN REINS QUICKLY IF NEED SHOULD RISE. THEY ALSO DENIED THAT RELATIONSHIP BETWEEN MONEY SUPPLY AND INFLATION

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EXISTED IN AUSTRIA. NEITHER SECRETARIAT NOR EDRC WERE CONVINCED BY AUSTRIAN REASONING. AUSTRIANS FELT THEIR

INTERNATIONAL COMPETITIVE POSITION TO BE IN GOOD SHAPE AND PROJECT GAIN IN EXPORT MARKET SHARES IN 1976. FURTHER, THEY ARGUED THAT CONTINUED ATTACHMENT OF AUSTRIAN SCHILLING TO DEUTSCHMARK WAS USEFUL FOR PURPOSES OF DOMESTIC DISCIPLINE. FINALLY, AUSTRIANS SAID THAT CONTRARY TO CONCLUSIONS OF SECRETARIAT'S ANALYSIS, PROSPECTIVE MEDIUM-TERM GROWTH RATE OF 4 PERCENT WOULD BE SUFFICIENT TO ABSORB INCREASES IN DOMESTIC LABOR SUPPLY. SECRETARIAT DID NOT REACT. EDRC CONCLUDED THAT (A) CURRENT AUSTRIAN MONETARY POLICY PRESENTS SERIOUS INFLATIONARY RISKS; (B) THERE IS NOT EVIDENCE THAT AUSTRIAN COMPETITIVE SITUATION HAS DETERIORATED, AND (C) NONETHELESS, PROJECTED INCREASE OF 7-1/2 PERCENT IN CONSUMER PRICES COMPARES UNFAVORABLY WITH THAT OF FRG, AND THUS AUSTRIAN COMPETITIVE FUTURE MAY NOT BE BRIGHT. END SUMMARY.

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: WITH PERFORMANCE OF AUSTRIAN ECONOMY IN FIRST HALF OF 1976 AND GROWTH OF WORLD TRADE STRONGER THAN OFFICIALLY EXPECTED AT TIME OF "MARCH PROGNOSIS," AUSTRIANS PRESENTED EDRC WITH UPWARD REVISION OF ALL DEMAND COMPONENTS. AUSTRIANS NOW FORECAST REAL GNP INCREASE OF 4 PERCENT FOR 1976 COMPARED WITH 2.5 PERCENT FORECAST IN MARCH. SECRETARIAT POINTED TO SQUEEZE ON PROFITS, AND QUESTIONED AUSTRIAN FORECAST OF 3 PERCENT INCREASE IN FIXED INVESTMENT. AUSTRIANS DENIED THAT CORRELATION EXISTED BETWEEN INVESTMENT AND PROFITS. MORE CONVINCING WERE AUSTRIAN POINTS THAT INVESTMENT SURVEYS SHOWED RENEWAL OF CONFIDENCE AND THAT ORDERS FOR INVESTMENT GOODS HAD PICKED UP. THEY ALSO NOTED THAT TEMPORARY ACCELERATED DEPRECIATION ALLOWANCES AND LOANS FROM THE EUROPEAN RECOVERY PROGRAM (ERP) FUND WOULD HELP SUPPORT INVESTMENT. SECRETARIAT ALSO FELT THAT AUSTRIANS HAD OVER-ESTIMATED CONTRIBUTION OF STOCKS TO 1976 GNP GROWTH AND EXPORT VOLUME GROWTH. ACCORDINGLY, REVISED SECRETARIAT FORECAST WILL BE IN 3-4 PERCENT RANGE, SOMEWHAT BELOW AUSTRIAN FORECAST.

3. IN REFDOC, SECRETARIAT HAD ATTRIBUTED SMALL RISE IN LIMITED OFFICIAL USE
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AUSTRIAN UNEMPLOYMENT RATE LARGELY TO EMIGRATION OF FOREIGN WORKERS, REDUCTION IN HOURS WORKED, AND EXPANSION OF EMPLOYMENT IN SERVICE SECTOR. AT EDRC, AUSTRIANS ACKNOWLEDGED INFLUENCE OF THESE FACTORS, BUT GAVE BULK OF CREDIT TO IMPACT OF SELECTIVE MANPOWER POLICIES, AND PARTICULARLY TO INVESTMENT SUPPORT ACTIVITIES OF ERP. AUSTRIANS EMPHASIZED THAT EVERY 1 BILLION SCHILLINGS SPENT BY ERP TO SUPPORT INVESTMENT BROUGHT FORTH 8 BILLION SCHILLINGS WORTH OF NEW INVESTMENT AND RESULTED IN CREATION OF 5,000 NEW JOBS. THEY ADDED THAT 1975

DROP IN REAL GNP WOULD HAVE BEEN ABOUT 1.6 PERCENT
GREATER THAN 2 PERCENT DECLINE ACTUALLY REGISTERED IN
ABSENCE OF ERP PROGRAMS. THERE WAS NO INDICATION FROM
SECRETARIAT AT EDRG THAT DRAFT SURVEY WOULD BE REVISED
TO REFLECT AUSTRIAN VIEWS.

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4. CONTRARY TO CONCLUSION OF SECRETARIAT ANALYSIS IN
REFDOC, AUSTRIANS INSISTED THAT MEDIUM-TERM GROWTH RATE
WOULD BE SUFFICIENT TO ABSORB INCREASING DOMESTIC SUPPLY
OF LABOR. THUS, THEY FELT THAT NO SPECIAL EFFORT WOULD
BE NEEDED TO INCREASE INVESTMENT ABOVE FORECAST LEVELS
OR TO INDUCE SHIFT TOWARD RELATIVELY LABOR-USING INVEST-
MENTS. AUSTRIANS COMMENTED THAT STRUCTURAL UNEMPLOY-
MENT RESULTING FROM CONTRACTION OF CERTAIN INDUSTRIES
(E.G. TEXTILES) COULD BE ALLEVIATED BY INCREASING USE OF
"JOINT VENTURES."

5. CURRENT ACCOUNT. FOR 1976, AUSTRIANS FORECAST

7.5 PERCENT GROWTH OF THEIR EXPORT MARKETS, 10 PERCENT GROWTH IN EXPORT VOLUMES, 5 PERCENT GROWTH IN IMPORT VOLUMES, AND TWO-THIRDS OF BILLION DOLLAR CURRENT ACCOUNT DEFICIT. THEY REJECTED SECRETARIAT CONTENTION THAT RISE IN RELATIVE UNIT LABOR COSTS IN AUSTRIA COMBINED WITH POLICY DECISION TO MAINTAIN SCHILLING PARITY WITH DEUTSCHMARK WOULD RESULT IN DETERIORATION OF AUSTRIAN LIMITED OFFICIAL USE

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COMPETITIVE POSITION AND LOSS OF EXPORT MARKET SHARES. THEY STRESSED THAT MAINTENANCE OF SCHILLING PARITY WITH DM WAS CONDUCIVE TO DOMESTIC WAGE AND PRICE DISCIPLINE. IN FACT, THEY SUGGESTED THAT REVISED DRAFT SURVEY UNDERLINE SUCCESS OF AUSTRIAN EXCHANGE-RATE POLICY. SECRETARIAT MAINTAINED THAT, AT BEST, AUSTRIAN EXPORT VOLUMES WOULD GROW IN LINE WITH 7.5 PERCENT INCREASE IN AUSTRIAN MARKETS. FURTHERMORE, SECRETARIAT ADVANCED VIEW THAT FALL IN EXPORT PRICES IN EARLY 1976, TOGETHER WITH RISE IN UNIT LABOR COSTS, WOULD DETER INVESTMENT IN EXPORT SECTOR AND HURT AUSTRIAN EXPORT PERFORMANCE IN MEDIUM TERM. MOREOVER, ALTHOUGH THERE WAS MINIMAL DISCUSSION OF WAGE AND PRICE PROSPECTS FOR 1976 (IN CONTRAST TO 1975 REVIEW), EDRC CONCLUDED THAT 7.5 PERCENT INCREASE IN CONSUMER PRICES IN 1976, WHILE BELOW OECD AVERAGE, WAS HIGH COMPARED WITH RELEVANT REFERENCE POINT, FRG. THUS, EDRC EXHORTED AUSTRIANS TO CONTINUE CLOSE VIGILANCE OVER WAGE AND PRICE DEVELOPMENTS.

6. DEMAND-MANAGEMENT POLICY; MONETARY POLICY: AUSTRIANS TOOK ISSUE WITH SECRETARIAT RECOMMENDATION THAT THEY ACT QUICKLY TO MOP UP EXCESS LIQUIDITY. THEY EMPHASIZED THAT (A) NO RELATIONSHIP EXISTED IN AUSTRIA BETWEEN MONEY SUPPLY AND INFLATION; (B) EXCESS LIQUIDITY IRRELEVANT SINCE DEMAND FOR CREDIT MINIMAL; (C) SYSTEM OF CREDIT CONTROLS, TOGETHER WITH FACT THAT MAJOR BANKS WERE NATIONALIZED, WOULD ALLOW AUTHORITIES TO TIGHTEN UP "INSTANTLY" IF NECESSARY. NEITHER SECRETARIAT NOR EDRC DELS TOOK POINTS (A) OR (B) SERIOUSLY. RE POINT (C), SEVERAL DELS NOTED AUSTRIANS HAD IGNORED LAG BETWEEN IMPLEMENTATION OF POLICY AND ITS ECONOMIC IMPACT. IN PARTICULAR, FRG STRESSED THAT INITIAL EFFECT OF SHIFT TOWARD MONETARY RESTRAINT WAS INCREASE IN VELOCITY AND HENCE NO CHANGE IN EFFECTIVE MONEY SUPPLY. AUSTRIANS ELICITED SOME SYMPATHY FROM SECRETARIAT IN ARGUING THAT MOVE TOWARD RESTRAINT AT THIS TIME WOULD DAMAGE INVESTORS' CONFIDENCE.

7. EDRC DISCUSSION OF AUSTRIAN FISCAL POLICY MINIMAL. AUSTRIANS INDICATED INTENTION TO REDUCE BUDGET DEFICIT GRADUALLY OVER TIME.

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8. EDRC CONCLUDED THAT REVISED OUTLOOK AS SEEN BY
SECRETARIAT PROVIDED SUPPORT FOR RECOMMENDATIONS IN
REFDOC THAT (A) AUSTRIAN FISCAL POLICY SHOULD SHIFT
GRADUALLY TOWARD RESTRAINT; (B) AUSTRIAN ECONOMY AWASH
WITH LIQUIDITY, AND TIMELY MOVE TOWARD MONETARY RESTRAINT
CALLED FOR.

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